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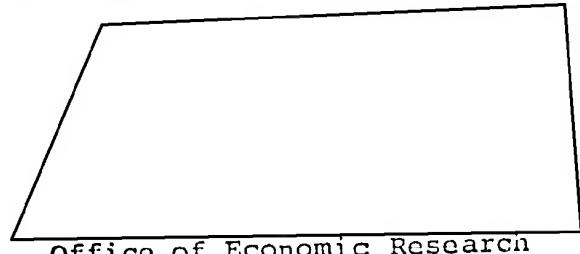
MEMORANDUM FOR THE RECORD

SUBJECT: Background Paper for President Ford's
Japan Visit

The attached report on South Korea: Status of
the Economy was forwarded [redacted] during the
week of 21 October for processing and transmission to
the National Security Council and the State Department.

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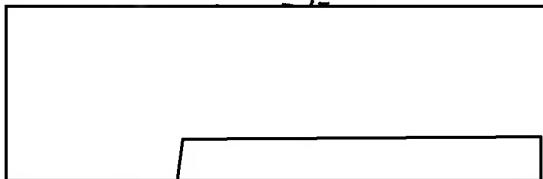
Office of Economic Research

Attachment:
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(21 Oct 74)

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SOUTH KOREA: STATUS OF THE ECONOMY

KEY CONCLUSIONS

- South Korea faces its steepest economic slump in years with the downturn likely to last well into 1975.
- The chief cause of the slump will be slackening foreign demand for South Korean goods in the United States and Japan which take nearly 70% of exports.
- Nonetheless, with unemployment on the rise and inflation still a problem the economic situation will exacerbate the government's already growing political difficulties.

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THE SOUTH KOREAN ECONOMY

1. South Korea is moving into its most pronounced economic slump in a decade. Although real growth this year will average 8%-10%, practically all the gains have come in the first half. The downturn will extend well into 1975 when real growth will probably register only slight gains. Growth prospects have declined essentially because of the economic downturn in major industrial countries which account for the bulk of Korea's exports and supply a large share of investment funds. Problems stemming from slow growth will add to Seoul's already growing political problems.

The Emerging Slump

2. The economy expanded rapidly during the first half of 1974 but the pace slowed sharply after mid-year. Real gross national product during the first half was 15% above the same 1973 period while industrial output was 20% above last year's average. In recent months, however, industrial output has stagnated and in some industries production has declined because of weak foreign demand for South Korean goods. With no turnaround expected in the months ahead, real GNP will register little or no gain during the second half of 1974 compared with the first.

3. So far the downturn has been concentrated in a relatively few industries. The hardest hit include textiles, electronics and other light consumer manufacturers that export the bulk of their output. Output in the important textile industry, for example, is down nearly 10% from the early 1974 peak, the sharpest decline in years. Although heavy industry continues to do relatively well, output gains there also have slowed in recent months.

4. Unemployment, although not yet a serious problem, is on the rise. Layoffs so far this year have totaled some 60,000 workers, somewhat less than 1% of the labor force. Several major US and Japanese firms in Korea are planning substantial layoffs. Most foreign and locally owned firms, however, are maintaining their labor force, preferring instead to reduce work hours when necessary. Nonetheless, employer groups and the government are concerned over the likelihood of increased labor unrest, particularly in urban areas.

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Government Policies

5. Seoul's primary economic objective has shifted from controlling inflation to maintaining employment and output. To accomplish this the government has reversed its fiscal and monetary policies. The budget -- in surplus during the first half of 1974 -- is now running a sizeable deficit. Seoul is increasing spending on public works, welfare, defense and government industrial projects. The public works program is essentially aimed at offsetting the decline in private sector employment.

6. Seoul is also providing special loans to private businessmen to help avoid a rash of bankruptcies. At least \$100 million is being used for this purpose with practically all of it going to small and medium-sized firms facing the most serious financial problems. Large-scale firms are better able to handle financial problems, now that credit restrictions are being eased. In some instances they have been able to increase their foreign borrowing.

7. The move to stimulate domestic demand will tend to aggravate Korea's inflation problem. Consumer prices in September were about 28% higher than the year before and wholesale prices rose even faster. Higher oil and other commodity costs were the chief factors raising prices during the first half of 1974. Higher labor costs are now becoming an important cause of inflation. To cope with cost push inflation the government has pressed employers and unions to keep wage settlements moderate. Seoul's objective is to hold inflation next year to half the current rate.

Trade and Payments

8. Higher oil and other commodity prices have boosted Korea's trade deficit sharply. For the year as a whole it will reach \$1.2 billion. Next year's deficit will approach that level. Because of weak demand in the US and Japan, which take nearly 70% of Korean exports, Seoul will have to revise down its 1975 goal of increasing overseas sales by 40%. If export growth slips too far, the government has indicated it will devalue its currency even at the cost of more inflation.

9. This year's current account deficit will approach \$1.5 billion compared with \$300 million in 1973. Most of the deficit is being offset by long-term capital inflows stemming in part

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from investment commitments made last year. Some slowdown in direct investment inflows particularly from Japan appears evident, however. The Japanese have cut back their investment plans because of political problems between the two countries as well as for economic reasons.

10. To compensate for a downturn in long-term inflows the Koreans have substantially increased their short-term borrowing abroad. This borrowing reached \$400 million during the first half of 1974 and will nearly double by year end. Korea's good international credit rating and low debt service payments -- 10% of exports in 1973 compared with 20% the previous year -- has made it relatively easy to obtain these funds. To help finance next year's payment deficit, Seoul is reportedly trying to obtain long-term loans from Arab oil exporters. Seoul is also seeking as much as \$1 billion in long-term loans from other sources including the World Bank, West European countries, Japan and the United States.

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